

## Franchising: what can a franchisee do if things go wrong?



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Your lawyer warned you how things could go wrong and what might happen if they did when he reviewed your draft franchise agreement. Nevertheless, you chose to go ahead anyway. Dazzled by your franchisor's website and brochures and buoyed up examples of franchisees who have done well, you decided to take the plunge. But things turn out badly for you. Despite working all hours and following the manual to a tee, you are struggling. Now you want out.

### **Can you get out of your franchise agreement?**

That depends on the terms of the agreement. If it was drawn up by a lawyer specializing in franchising, there will be a provision that enables the franchisor to terminate the agreement in a number of circumstances but none that allows you to do so. Unless you can sell your franchise, you have to wait until its term expires.

### **Selling your franchise**

If you can sell your franchise it may be the best solution all round. But there may be snags. For a start you will almost certainly need your franchisor's consent. The franchisor may not be inclined to give its consent if you owe it money or are otherwise in breach of contract. Repairing such breaches is likely to cost you money and that may be a problem if you have not been earning as much as you had hoped or have even lost money. If your premises are rented you will also need your landlord's consent because your lease is likely to contain a term requiring your landlord's licence to assign, such licence not unreasonably to be withheld. Outstanding rent or service charges and breaches of covenant are reasonable grounds for withholding

consent. Secondly, you have to find a purchaser and that may be difficult if the franchise has not done well. You have to be careful what you say to a prospective purchaser otherwise you could be liable to him for misrepresentation, negligent misstatement or breach of contract. Thirdly, your franchisee and landlord have to satisfy themselves that your purchaser will be, at the very least, no worse than you as franchisee and tenant. They need to make checks and enquiries which will cost money which who will have to pay. The incoming franchisee will have to undergo the same training as you. He or she will need the skills and resources to turn the franchise round. Often, the best person to do that is an existing franchisee who has made a success of his or her own territory and wants to expand. The opportunity to get to know other franchisees who might wish to buy you out is a very good reason for attending training courses and participating in your franchise association. And if you are to attract a willing purchaser among your fellow franchisees, it is in your interests not to rock the boat.

### **What if you die or fall ill?**

It often comes as an unwelcome surprise to franchisees, their spouses and children or other relations that a franchisee is rarely free to bequeath or otherwise dispose of his or her business s he or she pleases. That is because the franchisor needs to have confidence in all his franchisees and marriage or a blood relationship is no guarantee of competence or integrity. Having said that, if you are part of a successful husband and wife team or if your children have participated in the management of your business, your franchisor is likely to be more than happy to let your spouse or surviving family members carry on.

Your franchise agreement will almost certainly require your executors or administrators to notify your franchisor within a short time of your death. There may be a provision for the appointment of a manager for a short time whose salary or wages will have to be met by your successors. Within that time your spouse, children or others will have to decide whether or not they want to run the business. If there is nobody in your family who wants to carry on or if no member of your family is acceptable to the franchisor the franchise will revert to your franchisor unless your personal representatives can sell the franchise. Sometimes the agreement allows your estate a share of the proceeds of sale of the franchise but, as often as not, it does not.

Succession is one of the matters your lawyer should have considered when you asked him or her to review your draft franchise agreement. This is one of the few provisions of that agreement where there is often scope for negotiation. Before you start your negotiations make sure that you take good succes-



sion planning advice from a chartered accountant or other financial adviser.

Much the same considerations arise if you suffer an incapacitating physical or mental illness or accident. There is, however, one important difference in that you may enjoy some protection from discrimination on grounds of disability under the Equality Act 2010 although legal opinion is divided on that point.<sup>1</sup>

#### **What about Insolvency?**

Personal insolvency (*bankruptcy*) of a franchisee who is a natural person, or the administration or winding up of a franchisee that is a company, is quite different from death or physical or mental incapacity. There is likely to be a clause in the franchise agreement enabling the franchisor to terminate the agreement by notice with immediate effect should the franchisee be insolvent, suffer the appointment of a receiver or be unable to pay his, her or its debts as and when they fall due. That is because the franchisee's property, including his business, passes out of the franchisee's hands very suddenly. However, as the insolvency of a franchisee is likely to be almost as big a disaster for a franchisor as it is for the franchisee, it is in the interests of the franchisor to assist the franchisee if it can well before the franchisee reaches that point. The tragedy is that not all franchisors are prudent and some may be tempted to terminate the franchise before all is lost. Very careful judgment is therefore required from those advising the franchisee as to what the franchisee tells his franchisor and when.

#### **In what other circumstances can an agreement be terminated?**

A typical franchise agreement will contain a clause entitling the franchisor to terminate the agreement in a number of circumstances. One of these is insolvency which I have already discussed. Others include "material" or "fundamental breach", that is to say breach of a term that the franchisor regards as particularly important. These are awkward terms in a difficult area of the law but they would probably include a serious breach of confidence or attempting to dispose of the business without the franchisor's consent. It may also include wilful and persistent breaches of less important provisions of the agreement if the franchisor has asked you to stop or repair the breach and you have not complied.

The consequences of termination under this clause are likely to be enormous. First, you lose your livelihood. Not only do you have to stop trading under the franchisor's marks and colours but you will probably find a covenant restricting your right to run a similar business for some time. If this covenant is reasonable for the protection of the business

it will be upheld in which case you may be ordered by a court to comply with it or risk prison or other penalty if you fail to do so.

Secondly, it will cost you. You have to pay what you owe to your franchisor under the terms of your franchise agreement. At the very least that will be any fees or service charges outstanding. If you trade from rented premises you remain liable under your lease unless your landlord is prepared to accept a surrender. When your lease does come to an end you will probably receive a schedule of dilapidations which will require a surveyor's advice, protracted negotiations and eventually a bill. If you owe money to your bank and it has a charge over your home you risk possession proceedings. There may be other creditors such as leasing companies, utilities, HM Revenue and Customs, the local authority and trade creditors.

Finally, any one of these creditors can sue you or serve a statutory demand in which case you will end up in court. There is no longer legal aid for business disputes so you will have to pay your own and possibly the other side's legal fees, not to mention those of mediators, expert witnesses and other professionals, out of your own pocket.

#### **Is there anything you can do about it?**

Possibly but don't bank on it. If you entered the franchise on a statement of fact or opinion that turns out to be wrong you may have a claim or counterclaim against your franchisor for misrepresentation, negligent misstatement or breach of warranty. However, your agreement is likely to contain an acknowledgement by you that you have not relied on any statement of fact or opinion from your franchisor, a declaration that the document contains all the terms of the agreement and that this agreement supersedes all others. These clauses can sometimes be set aside under the Unfair Contract Terms Act 1977<sup>2</sup> or otherwise but there may be other difficulties. Many franchisors require prospective franchisees to submit their own business plan before granting a franchise. If that plan turns out to be flawed they can hardly blame their franchisors. If you believe that your troubles stem from discrimination on grounds of race, sex, faith, disability, age, sexual orientation or gender identity you may have redress under the Equality Act 2010 but, as I say, opinion is divided on that point. Your best bet is take proper financial as well as legal advice, prepare a plan B and arrange funding through insurance or otherwise before you take a franchise in the first place. Should you want to discuss this topic further, do not hesitate to call me on **0800 962 055** or email me at [jane.lambert@nipclaw.com](mailto:jane.lambert@nipclaw.com). □

<sup>1</sup> See s.13, s.15 and s.19 of the Equality Act 2010 c. 15 <http://www.legislation.gov.uk/ukpga/2010/15>

<sup>2</sup> 1977 c. 50 <http://www.legislation.gov.uk/ukpga/1977/50>